FICCI CALL TO END ANOMALOUS TAX TREATMENT OF ESOPs
'Align Income Tax Rules with SEBI Guidelines Framed for ESOPs'

NEW DELHI, October 9, 2010. The anomalous tax treatment of ESOPs arising out of the inconsistent determination of perquisite value in respect of shares allotted to employees under ESOPs, vis-à-vis SEBI guidelines, is resulting in ESOPs being taxed at a price higher than the concession/discount given by the employer.

In a representation to the Finance Ministry, FICCI has stressed the need for aligning the Income Tax rules with the SEBI guidelines framed for ESOPs.

FICCI has noted that SEBI guidelines provide the Fair Market Value (FMV) of a stock option as the market price prevalent on the grant date, not to be subsequently adjusted for changes in the price of the underlying stock or its volatility, the life of the option, dividends on the stock, or the risk free interest rate. It also clearly spells out that where ESOPs are granted free of cost or at concessional rate, how the deferred compensation would be treated.

Section 17(2)(vi) of the Income Tax Act, amended last year, inter-alia provides for taxation of ESOPs as perquisite in the hands of employees. The same will include the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee. For this purpose, the value of any specified security or sweat equity shares shall be the fair market value of the specified security or sweat equity shares, as the case may be, on the date on which the option is exercised by the assessee as reduced by the amount actually paid by, or recovered from, the assessee in respect of such security or shares. These provisions are identical to what was provided under the FBT regime.

FICCI has pointed out that while doing so, it has not been appreciated that prior to the FBT, the employee, though, was subject to tax on ESOPs, but only on capital gains arising from the sale of shares allotted to him and not on notional perquisite value, determined with reference to the FMV on the date on which the option is exercised. The said system of taxation had facilitated the employer to retain talented person in his organization.

ESOPs for all listed companies are issued as per the SEBI guidelines.

FICCI has suggested that the FMV and the determination of discount / concession at which shares are issued under ESOPs should be in conformity with SEBI guidelines and employees be taxed only on the concession / discount actually given by the employer at the time of grant and not on notional perquisite value determined with reference to the FMV on the date on which the option is exercised.

Subsequent gain, if any, accruing to the employee due to favourable market movements by the date of vesting or exercise of option would in any case be subject to capital gains tax on actual sale of shares and would not thus affect the revenue, says FICCI.

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